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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1701

ROBERT PARKER, Trustee for
OLYMPIA CONSTRUCTION CO., Bankrupt,
Petitioner,
vs.
KLOCHKO EQUIPMENT RENTAL CO., INC.,
MARIO TRUCKING COMPANY, PRICE
BROTHERS COMPANY, DOUG SCHROEDER, INC.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

CROSS, WROCK, MILLER & VIESON
By: WILLIAM A. COUGHLIN, JR.
ANDREW A. PATERSON
CRAIG A. ANDERSON
400 Renaissance Center
Suite 1900
Detroit, Michigan 48243
Phone: (313) 259-1144
Counsel for Petitioner

Interstate Brief & Record Co., Wurlitzer Bldg., 1509 Broadway, Detroit, MI 48226
962-8745 962-8746

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ROBERT PARKER, Trustee for OLYMPIA CONSTRUCTION CO., Bankrupt, Petitioner,

vs.

KLOCHKO EQUIPMENT RENTAL CO., INC., MARIO TRUCKING COMPANY, PRICE BROTHERS COMPANY, DOUG SCHROEDER, INC., Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner, ROBERT E. PARKER, Trustee in Bankruptcy for Olympia Construction Company, prays that a writ of certiorari issue to the United States Court of Appeals for the Sixth Circuit to review the decision entered January 11, 1979 in Case No. 76-1711, entitled Robert E. Parker, Trustee for Olympia Construction Co., Bankrupt, Petitioner v Klochko Equipment Rental Co., Inc., Mario Trucking Company, Price Brothers Company, Doug Schroeder, Inc., Respondents, and the order of that court denying Petitioner's Petition for Rehearing.

OPINIONS BELOW

The order of the Court of Appeals denying rehearing is unreported, and is printed in the attached Appendix A at p. A1.

The opinion of the Court of Appeals reversing the Bankruptcy Court is reported at 590 F2d 649, and is printed in the attached Appendix A at p. A2.

The opinion of the Court of Appeals in *Selby* v *Ford Motor Co.*, a companion case, is reported at 590 F2d 642, and is printed in the attached Appendix A at p. A13.

The opinion of the district court, affirming the decision of the Bankruptcy Court was delivered from the bench, and is printed from the transcript of the session in Appendix A at p. A27.

The opinion and judgment orders of the Bankruptcy Court are unreported, and are printed in Appendix A at p. A32.

STATEMENT OF JURISDICTION

The opinion of the Court of Appeals was entered on January 11, 1979. On February 13, 1979 the order of the Court of Appeals denying petitioner's petition for rehearing en banc was entered. That order is printed in Appendix A, p. A1. This petition is, therefore, timely.

This Court's jurisdiction is invoked under 28 USC §1254(1) and Rule 19 of the Rules of this court.

QUESTIONS PRESENTED

A.

May the Michigan Builders Trust Fund Act be interpreted by the Court of Appeals to supersede the distributional scheme of the Bankruptcy Act by permitting effective preferences to certain creditors?

B.

May the Court of Appeals refuse to follow a state Supreme Court's interpretation of state law contrary to *Erie R. Co.* v *Tompkins*?

C.

Is *en banc* consideration required under Rule 35(a) of the Federal Rules of Appellate Procedure to overrule previous decisions of the same Circuit Court of Appeals as the 3rd and 5th Circuit have indicated, or may one panel of the circuit overrule other panels of the circuit as the Court of Appeals for the Sixth Circuit has indicated?

CONSTITUTIONAL AND STATUTORY PROVISIONS AND RULES INVOLVED

U.S. Const., art I, §8, cl. 4:

> "The Congress shall have Power
>
> * * *
>
> To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States . . ."

11 USC §96(b):

> "Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: Provided, however, That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee. For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

11 USC §104:

> (See Appendix B for full text of 11 USC §104).

11 USC §110(a):

> (See Appendix B for full text of 11 USC §110(a)).

Federal Rule of Appellate Procedure 35(a):

> "Determination of Causes by the Court in Banc.
>
> (a) When Hearing or Rehearing in Banc Will be Ordered. A majority of the circuit judges who are in regular active service may order that an appeal or other proceeding be heard or reheard by the court of appeals in banc. Such a hearing or rehearing is not favored and ordinarily will not be ordered except (1) when consideration by the full court is necessary to secure or maintain uniformity of its decisions, or (2) when the proceeding involves a question of exceptional importance."

MCL §570.151 (1966):

> "Building contract fund; status as a trust fund.
>
> In the building construction industry, the building contract fund paid by any person to a contractor, or by such person or contractor to a subcontractor, shall be considered by this act to be a trust fund, for the benefit of the person making the payment, contractors, laborers, subcontractors or materialmen, and the contractor or subcontractor shall be considered the trustee of all funds so paid to him for building construction purposes. As amended P.A. 1966, No. 104, §1, Eff. Oct. 1."

STATEMENT OF THE CASE

This case arises under the Bankruptcy Act, specifically §60(b) (11 USC §96), §70(a) (11 USC §110(a)), and §64 (11 USC §104).

Olympia Construction Company ("Bankrupt") filed its voluntary Petition in Bankruptcy and was adjudged a bankrupt on December 21, 1973. Bankrupt was an underground subcontractor working in the Southeastern Michigan area.

Defendant, Price Brothers Company ("Price Brothers"), was a supplier of pipe and sewer materials to Bankrupt for use by it in a public construction job.

Defendant, Doug Schroeder, Inc. ("Doug Schroeder"), was a supplier of sand and gravel to Bankrupt for use by it in various construction jobs, both public and private.

Defendant, Mario Trucking Company ("Mario") was a supplier and hauler of sand and gravel to Bankrupt for use by it in various public construction jobs.

Defendant, Klochko Equipment Rental Company, Inc. ("Klochko"), had rented various machinery and equipment to Bankrupt for use by it in various public construction jobs.

Plaintiff-Trustee, Robert E. Parker, sued Defendants in an adversary proceeding under Part VII of the Bankruptcy Rules, claiming that various payments to each of them constituted preferences under §60(a) of the Bankruptcy Act enabling each Defendant to receive more than its pro rata share of the monies due it from the Bankrupt estate.

Proceedings on Plaintiff-Trustee's action were held before the Honorable Harold H. Bobier, Bankruptcy Judge for the Eastern District of Michigan, Eastern Division in Flint, Michigan. Judge Bobier, in written and oral Opinions and Orders, granted Plaintiff-Trustee judgments in the amounts sought. United States District Judge for the Eastern District of Michigan, James Harvey, on a consolidated appeal from those judgments, rendered an oral opinion from the bench on July 28, 1976, affirming the judgments below, and a written Order and Judgment was entered thereon on July 28, 1976. Defendants appealed to the United States Court of Appeals for the Sixth Circuit. The Sixth Circuit issued its opinion January 11, 1979, reversing the judgments below. Plaintiff-Trustee filed a Petition for Rehearing and Suggestion for Rehearing *En Banc* and the Sixth Circuit on February 13, 1979, issued its Order denying the Petition for Rehearing.

The Court of Appeals opinion sets forth the factual circumstances giving rise to Plaintiff-Trustee's preference action for monies paid the Defendants:

> "During the summer of 1973 Olympia's indebtedness grew to the extent that the materialmen became apprehensive. M & K, the general contractor on the public jobs, intervened. On September 11, 1973 M & K issued two checks, one for $25,000 payable jointly to Olympia and Mario, the other for $6,883.56 payable jointly to Olympia and Price. M & K issued a similar joint check to Schroeder and Olympia on October 1. M & K also issued a joint check for $20,000 to Olympia and Klochko in settlement of a garnishment proceeding brought by Klochko. Olympia indorsed all four checks over to the materialmen.

> "On the private construction project, the pattern of events was similar, and on November 1, 1973 the general contractor issued a joint check for $3,117.32 which Olympia indorsed to Schroeder."

The Bankruptcy Court found a reachable (by Plaintiff-Trustee) "property" interest under §70(a) of the Bankruptcy Act in the above monies and found present all other elements of a §60(b) preference, and awarded Plaintiff-Trustee judgment thereon.

The Court of Appeals applied the holding of the companion case, *Selby* v *Ford Motor Co*, 590 F2d 642 (6th Cir, 1979) and held that "by virtue of the Michigan Builders Trust Fund Act, Michigan Comp. Laws Ann. §570.151 (1966), the funds paid to Schroeder [on the private construction job] were never Olympia's property." The Court also applied the same rationale to the remaining claims arising out of the *public* construction jobs. In so doing, the Court of Appeals overruled two previous Sixth Circuit decisions: *General Insurance Co* v *Lamar Corp.*, 482 F2d 856 (6th Cir, 1973) and *The R C Mahon Company* v *Hallis*, 112 F2d 1007 (6th Cir, 1940) (adopting the decision of the District Judge below, *In Re Edward Misch Co's Estate*, 34 F Supp 781 (ED Mi 1939)). In addition, the Court of Appeals decision refused to follow a decision of the Michigan Supreme Court, *Club Holding Co* v *Flint Citizens Loan and Investment Co*, 272 Mich 66, 261 NW 133 (1935). All of these previous decisions had held the Michigan Builders Trust Fund Act *not* applicable to public construction jobs.

Plaintiff-Trustee now seeks review of the Court of Appeals decision of January 11, 1979 and of its order of February 13, 1979 denying the petition for rehearing and suggestion for rehearing *en banc*.

ARGUMENT

A.

THE RULING BELOW ERRONEOUSLY GIVES A STATE STATUTE SUPREMACY OVER THE DISTRIBUTION SCHEME OF THE BANKRUPTCY ACT.

The Court of Appeals for the Sixth Circuit in this case and in the companion case, *Selby* v *Ford Motor Company*, 590 F2d 642 (6th Cir, 1979), undermines the overriding supremacy of the Bankruptcy Act by finding that a state (Michigan) statute (MCL §570.151 (1966)) imposes a trust for the benefit of selected creditors upon certain property of a bankrupt contractor, and thus defeats an otherwise valid preference claim of the contractor's trustee in bankruptcy. These decisions are contrary to the United States Constitution and this Court's decisions in *International Shoe Co* v *Pinkus*, 278 US 261 (1929), and *Perez* v *Campbell*, 402 US 637 (1971).

By express grant of authority in the Constitution, Congress has established "uniform laws on the subject of Bankruptcies." U.S. Const., art I, §8, cl. 4. The Bankruptcy Act is paramount and "necessarily excludes state regulation." *International Shoe Co* v *Pinkus, supra*, at 265. Thus, a state statute that has as its object or effect interference with the collection and distribution schemes of the Bankruptcy Act "frustrates the full effectiveness of federal law [and] is rendered invalid by the Supremacy Clause." *Perez* v *Campbell, supra*, at 652.

Section 70(a) of the Bankruptcy Act vests in the bankruptcy trustee title to the bankrupt's "property". Although the parameters of the definition of property are left to state law, state statutes cannot, by definitional power, circumscribe the distribution scheme of Section 64 of the Bankruptcy Act. Statutorily

or judicially created liens on a bankrupt's property may negate an, property interest claimed by the bankrupt's trustee, and thereby conflict with and frustrate the intent of the Bankruptcy Act.

In the present case the Sixth Circuit holds that a Michigan statute imposes a trust on funds in the construction industry—a trust for the benefit not of general creditors, but of the job or construction trade creditors. The Court concludes that the bankrupt had no property interest in monies impressed with such a trust. The decision below creates nothing more than a poorly disguised state priority. It is contrary to this Court's decisions in *International Shoe Co* v *Pinkus* and *Perez* v *Campbell*. The decision vitiates the Bankruptcy Act's distributional scheme in nearly all construction industry bankruptcies in Michigan. It is at odds with decisions in other circuits, decisions recognizing and upholding the supremacy of the Bankruptcy Act as against state created liens or trusts; e.g., *N W Day Supply Company* v *Valenti*, 343 F2d 756 (1st Cir, 1965); *In Re Crosstown Motors, Inc*, 272 F2d 224 (7th Cir, 1959); *Elliot* v *Bumb*, 356 F2d 749 (9th Cir, 1966).

B.

THE RULING BELOW DOES NOT FOLLOW STATE LAW WHICH WOULD HOLD THE MICHIGAN STATUTE OF NO EFFECT IN THE PRESENT CASE.

In giving supremacy to the Michigan statute, the Court of Appeals did not rely on interpretations of the act by that State's Supreme Court. Indeed its decision is directly contrary to a specific holding of the Michigan Supreme Court in *Club Holding Co.* v *Flint Citizens Loan & Investment Co., supra*. It is also directly contrary to

earlier decisions of the Sixth Circuit; *General Insurance Company* v *Lamar Corp., supra* and *R. C. Mahon Corp.* v *Hallis, supra*. Furthermore it is directly contrary to the approval given the *Lamar* case by the Michigan Supreme Court in *National Bank of Detroit* v *Eames and Brown*, 396 Mich 611, 242 NW2d 412 (1976).

The bankrupt contractor in this case was working principally on public construction jobs — a fact important to an understanding of the Michigan and Sixth Circuit cases interpreting the Michigan statute. The earliest Michigan case, *Club Holding Co., supra*, had held the Michigan Builders Trust Fund Act of no effect in the context of a public construction job. That court said:

> ". . . We apprehend that the parties are desirous of a determination of the applicability of the [Michigan Builders Trust Fund Act]. . .
>
> * * *
>
> ". . . The act in question stands alone, without any reference to another, it is in harmony with the various provisions of the mechanic's lien law, and *we cannot presume, in the absence of explicit language, that it was intended to apply to the erection of public buildings or to public works.* To do so might have a negatory effect on the provisions of the 1905 act as amended, and strike from the books a line of well-understood and established authorities." *Club Holding Co.* v *Flint Citizens Loan & Investment Co.*, 272 Mich at 72, 261 NW at 135. (Emphasis added)

The Michigan Supreme Court subsequently held the Michigan Builders Trust Fund Act did provide a viable civil remedy to creditors in the context of *private*

construction jobs; *B. F. Farnell Co.* v *Monahan*, 377 Mich 552, 141 NW2d 58 (1966).

In *General Insurance Co.* v *Lamar, supra,* the Sixth Circuit was asked to reconsider the *Club Holding Co.* case in light of the later *B. F. Farnell* case. The Court of Appeals stated in *Lamar:*

> "This appeal presents primarily the question whether under the Michigan Building Contract Fund Act of 1931, M.C.L.A. §§570.151 - 570.153, money paid to a contractor performing a public project constitutes a trust fund for the payment of subcontractors and materialmen for labor and material furnished on the project. We determine that it does not and reverse the judgment of the district court." At p. 856, 857.

The Court then carefully considered the *Club Holding Co.* case in light of the *B. F. Farnell* case and concluded:

> ". . . the above quotation makes it clear that any pronouncements in *Club Holding* that do not concern the creation of a civil remedy by the Act remain unaffected. Accordingly, the decision in *B. F. Farnell* did not extend the reach of the statute to 'the erection of public buildings or to public works.' *Club Holding, supra,* 272 Mich at 72, 261 NW at 135. *We must follow the construction given the Act by the Michigan Supreme Court, and we therefore hold that the Act does not make funds paid on public projects a trust fund in the hands of a contractor."* At p. 860. (Emphasis added)

Subsequent to the decision in *Lamar,* the Michigan Supreme Court in *National Bank of Detroit* v *Eames and Brown, supra,* quoted verbatim the Sixth Circuit's

discussion in *Lamar* of the legislative history of the Michigan Builders Trust Fund Act that had been used to rationalize its *Lamar* holding. The Michigan Supreme Court then said: "The purpose of the Act is to create a trust fund for the benefit of materialmen and others under *private* construction contracts." 396 Mich at p. 622, 242 NW2d at 417. (Emphasis added) Thus, the Michigan Supreme Court clearly acknowledged its earlier *Club Holding Co.* decision as to the inapplicability of the Michigan Building Trust Fund Act to public construction jobs.

Despite these clear and recent pronouncements to the contrary by the Michigan Supreme Court and despite the Sixth Circuit's own earlier decisions, the present decision refuses to follow state law and as a result gives a state statute supremacy over the Bankruptcy Act. Thus this decision is not only contrary to the Supremacy Clause but is also contrary to this Court's decision in *Erie R. Co.* v *Tompkins,* 304 US 64 (1938), and *Chicago Board of Trade* v *Johnson,* 264 US 1 (1923).

C.

THE RULING BELOW PERMITS ONE PANEL OF THE CIRCUIT TO OVERRULE ANOTHER PANEL OF THAT CIRCUIT AND THUS CONFLICTS WITH THE FIFTH AND THIRD CIRCUITS' INTERPRETATION OF RULE 35(a) OF THE FEDERAL RULES OF APPELLATE PROCEDURE REQUIRING EN BANC CONSIDERATION TO OVERRULE A PREVIOUS DECISION.

In the present case the panel of the Court of Appeals overruled earlier Sixth Circuit cases by other panels; *General Insurance Co.* v *Lamar, supra,* and *The R. C. Mahon Company* v *Hallis, supra.* Rule 35(a) of the Federal Rules of Appellate Procedure contemplates an *en banc*

hearing when "necessary to secure or maintain uniformity" of the circuits' decisions. The Fifth Circuit has interpreted Rule 35(a) as placing "beyond the province" of a panel of the circuit the reversal of another panel of the circuit. *Miller* v *San Sebastian Gold Mines, Inc.*, 540 F2d 807 (5th Cir, 1976); *United States* v *Lewis*, 475 F2d 571 (5th Cir, 1973). The Third Circuit has also taken this view:

> "M. Rehearing, Criteria and Practice for Voting for.
>
> * * *
>
> 2. *Avoiding Inter-Circuit Conflict.* It is the tradition of this Court that internal stability of its panel decisions be preserved. To avoid conflicts in panel decisions no subsequent panel may overrule a published opinion of a previous panel. Court in banc consideration is required to overrule a previous decision of this Court." United States Court of Appeals for the Third Circuit, Internal Operating Procedures, 63 F.R.D. 319 (1974).

The decision in the present case thus squarely conflicts with the Fifth and the Third Circuits' interpretation of Rule 35(a) and similar views espoused by other circuits. See also, *In Banc Proceedings*, 37 ALR Fed 274, 293 and cases cited therein.

CONCLUSION

The Court of Appeals has declined to follow decisions of a state's highest court and its own prior decisions construing a state statute and, having done so, ruled that the state statute as construed by the Court of Appeals supersedes the priority provisions of the Federal Bankruptcy Act.

Further, the Court has overruled its own prior decisions without a hearing *en banc*, as the Third and Fifth Circuits have indicated is required by Rule 35(a).

For the reasons stated in the Petition, a writ of certiorari should be granted.

Respectfully submitted,

CROSS, WROCK, MILLER & VIESON

By: William a. Coughlin, Jr.
Andrew A. Paterson
Craig A. Anderson
Attorneys for Petitioner
400 Renaissance Center,
Suite 1900
Detroit, MI 48243
(313) 259-1144

Dated: May 11, 1979

APPENDIX A

ORDER

(United States Court of Appeals
For the Sixth Circuit)

(Filed February 13, 1979)

ROBERT E. PARKER, Trustee for OLYMPIA CONSTRUCTION CO., Bankrupt, Plaintiff-Appellee v. KLOCHKO EQUIPMENT RENTAL CO., INC., Defendant-Appellant; MARIO TRUCKING COMPANY, Defendant-Appellant; PRICE BROTHERS COMPANY, Defendant-Appellant; DOUG SCHROEDER, INC., Defendant-Appellant. No. 76-2395/6/7/8.

Before: WEICK, LIVELY and MERRITT, Circuit Judges.

No judge of the Court having moved for rehearing *en banc*, the petition for rehearing has been referred to the hearing panel for disposition.

Upon consideration, it is ORDERED that the petition for rehearing be and hereby is denied.

ENTERED BY ORDER OF THE COURT

/s/ John P. Hehman,
Clerk

OPINION

(United States Court of Appeals
For the Sixth Circuit)

(Decided and Filed January 11, 1979)

On Appeal from the United States District Court for the Eastern District of Michigan.

Before: WEICK, LIVELY and MERRITT, Circuit Judges.

Merritt, Circuit Judge, delivered the opinion of the Court, in which WEICK, Circuit Judge, joined. LIVELY, Circuit Judge, (pp. 8-9) filed a separate dissenting opinion.

MERRITT, Circuit Judge. The trustee in bankruptcy of a subcontractor seeks to set aside as preferences payments made to four materialmen within four months of the subcontractor's bankruptcy.[1] The district court for the Eastern District of Michigan held that the payments were preferences and granted judgment to the trustee. The materialmen appealed. We reverse on the grounds that the payments were made from funds

[1] Section 60 of the Bankruptcy Act defines preference as "a transfer . . . of any of the property of a debtor . . . for . . . an antecedent debt, made . . . while insolvent and within four months" of bankruptcy, the effect of which will enable the "creditor to obtain a greater percentage of his debt than some other creditor of the same class." 11 U.S.C. § 96 (1976).

subject to the Michigan Builders Trust Fund Act[2] which were not the "property" of the bankrupt under § 70 of the Bankruptcy Act, 11 U.S.C. § 110 (1976).[3]

I. FACTS

The subcontractor, Olympia Construction Co., filed its petition in bankruptcy on December 21, 1973. During the course of 1973 the four materialmen, Klochko Equipment Rental Co., Mario Trucking Co., Price Brothers Co. and Doug Schroeder, Inc., provided materials and supplies to Olympia, which was a subcontractor to Markward & Karafiles (M & K) on *public* construction projects in the vicinity of Detroit. During the same period Doug Schroeder, Inc. was also a materialman to Olympia in connection with work on a *private* project in which Plymouth Construction Co. was the general contractor.

During the summer of 1973 Olympia's indebtedness grew to the extent that the materialmen became apprehensive. M & K, the general contractor on the public jobs, intervened. On September 11, 1973 M & K issued two checks, one for $25,000 payable jointly to

[2] "In the building construction industry, the building contract fund paid by any person to a contractor, or . . . to a subcontractor, shall be considered by this act to be a trust fund, for the benefit of the person making the payments, [and] contractors, laborers, subcontractors or materialmen . . . ." Mich. Comp. Laws Ann. § 570.151 (1967).

[3] Section 70 provides that the trustee in bankruptcy shall be "vested by operation of law with . . . title" to all the "property" of the bankrupt.

Olympia and Mario, the other for $6,883.56 payable jointly to Olympia and Price. M & K issued a similar joint check to Schroeder and Olympia on October 1. M & K also issued a joint check for $20,000 to Olympia and Klochko in settlement of a garnishment proceeding brought by Klochko. Olympia indorsed all four checks over to the materialmen.

On the private construction project, the pattern of events was similar, and on November 1, 1973 the general contractor issued a joint check for $3,117.32 which Olympia indorsed to Schroeder.

II. THE PRIVATE CONSTRUCTION PROJECT

The issue presented by the payment to Schroeder for materials supplied to the *private* construction project is identical to that in *Selby* v. *Ford Motor Co.*, No. 76-1711 (6th Cir. 1978). Accordingly, we hold that by virtue of the Michigan Builders Trust Fund Act, Mich. Comp. Laws Ann. § 570.151 (1967),[4] the funds paid to Schroeder were never Olympia's property. Therefore, Olympia's trustee in bankruptcy cannot set aside the payment under § 60 of the Bankruptcy Act, 11 U.S.C. § 96.

III. THE PUBLIC CONSTRUCTION PROJECTS

In *Selby* v. *Ford Motor Co., supra,* we analyzed the property rights which are created by the Michigan Builders Trust Fund Act and held that these rights should be recognized under the Bankruptcy Act. We found that trust funds due or in the hands of a

[4] *See* note 2, *supra,* for the text of the Act.

contractor as trustee are not his "property" under § 70 of the Bankruptcy Act and, therefore, payments of such trust fund may not be set aside as preferential transfers under § 60.

The instant case and *Selby* differ in only one respect. *Selby* involved a private construction project while this case involves public projects. Thus, the only new question raised on this appeal is whether the state statutory trust, and our holding in *Selby*, apply to *public* as well as *private* construction projects.

The Michigan act, by its express terms, applies to "the building contract fund paid by *any* person to a contractor or . . . a subcontractor," and we would have no hesitancy or difficulty in applying the act to public construction projects, except for language that appears in our opinion in *General Insurance Co. of America* v. *Lamar Corp.*, 482 F.2d 856 (6th Cir. 1973). We have determined, however, that this language was not necessary to the opinion, narrowly read, and we decline to follow it.

In the *General Insurance* case, a general contractor on a public construction project owed money for prior unrelated work to a materialman. The general contractor paid the materialman money received from the owner on the public construction project. The materialman applied part of the payment from the contractor to the pre-existing indebtedness and used the funds for general business purposes. When the general contractor defaulted, his surety on the performance bond took over the work. The surety brought suit against the materialman for that portion of the payment applied to the pre-existing indebtedness. Judge McCree, writing for this Court, reversed a judgment in favor of the

surety on two grounds. His opinion said (1) the Michigan statutory trust applies only to private construction projects, not public projects and thus does not affect the rights of the parties; and (2) "under Michigan law," the materialman "was under no duty to apply the funds to the . . . [public project rather than the prior indebtedness] in the absence of fraud or an express direction by the [contractor] . . . ." 482 F.2d at 861.

We believe the second ground for the Court's decision quoted above is correct and was dispositive of the case, whether or not the Michigan statutory trust governed the rights of the parties. Even if the Court had applied the statutory trust, the materialman in that case would have been the beneficiary of the trust fund, not the trustee. After the funds were paid to him and were used for general business purposes, tracing would have been impossible. Neither the common law of Michigan nor the statutory trust imposes a duty on the materialmen as beneficiaries to apply the payment by the contractor to current work rather than prior indebtedness in the absence of any direction to do so. It would have been the responsibility of the contractor both as trustee under the statutory trust and as a contracting party under Michigan common law to direct the application of the funds.

We believe, therefore, that the language in the *General Insurance* opinion stating that the builders trust statute is inapplicable to public projects was unnecessary, and we decline to follow it.[5] This language was based on dicta from a prior Michigan case, *Club Holding Co.* v. *Flint Citizens Loan and Investment Co.*, 272 Mich. 66, 261 N.W. 133 (1935), which held that Michigan Builders Trust Fund Act does not create a private, civil right of action. The *Club Holding* case was overruled in *B. F. Farnell Co.* v. *Monahan*, 377 Mich. 552, 141 N.W.2d 58 (1966), which established that the statute does give rise to a private right of action. We do not believe the *Club Holding* case is viable authority in Michigan now, and Michigan courts have not been called upon to rule upon the question of the applicability of the statute in the context of a public construction project.[6]

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[5] The dissenting opinion makes the point that according to the express language of the *General Insurance* opinion the "specific holding" of the case is that the Michigan statutory trust does not apply to public projects. The dissent accurately states that we treat this "very language" as dicta, and we find instead that language which the *General Insurance* opinion characterized as dicta is in fact the holding of the case. Our method of analysis, however, is well within the common law tradition. We believe that the *General Insurance* opinion reaches the correct result but that its reasoning is faulty. The court should have rested its decision on different grounds.

[6] Our dissenting brother correctly states that the Michigan Supreme Court in *National Bank of Detroit* v. *Eames and Brown*, 396 Mich. 611, 622, 242 N.W.2d 412, 417 (1976), a case involving a private construction project, said that the Act creates a statutory trust "under private construction contracts." But we do not read the opinion as committing the courts of Michigan to a rule that the statutory trust applies "only" to private construction projects, and not to public projects. The court had no reason to reach that question in the *National Bank of Detroit* case and did not discuss it.

The only reason given in the *General Insurance* case for not applying the statutory trust to public projects is not convincing. The opinion states that the statutory requirement that contractors on public projects provide a payment bond protects subcontractors and materialmen and makes the statutory trust unnecessary for their protection on public projects. 452 F.2d at 860. But in order for subcontractors and materialmen on public projects to establish their rights to payment from the surety under the statutory payment bond, they must perfect their claims and file notice as if they were perfecting a mechanic's lien.[7] The main purpose of the Michigan statutory trust, as our opinions in *General Insurance* and *Selby* recognized, was to provide a better remedy than those provided by the mechanics lien and similar state laws. We were in error in stating in *General Insurance* that, under Michigan law, subcontractors and materialmen are better protected under the statutory payment bond applicable to public construction projects than under the mechanics lien laws applicable to private jobs.

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[7] *Compare* the Michigan mechanics lien law, Mich. Comp. Laws Ann. § 570.1 (1967) ("Every person . . . who shall furnish any labor or materials in or for [any building] . . . shall have a lien therefor upon such [building] . . . Provided, That [the materialman] shall within 90 days after furnishing the first of such material . . . serve on the owner . . . a written notice") with the public construction payment bond statute, Mich. Comp. Laws Ann. § 129.207 ("A claimant not having a direct contractual relationship with the principal contractor shall not have a right of action upon the payment bond unless (a) he has within 30 days after furnishing the first of such material . . . served on the principal contractor a written notice . . . and (b) he has given written notice to the principal contractor and the governmental unit involved within 90 days from the date on which the claimant . . . supplied the last of the material . . . .")

The facts of the instant case undermine the assumption on which the *General Insurance* dicta were based, the assumption that aggrieved materialmen on public jobs do not need the trust fund remedy because they can rely on the payment bond statute. Here, the materialmen have foregone their right to recover on the payment bond. Confident in their belief that the funds received from M & K were theirs to keep, the materialmen had no apparent need to file the appropriate notices which are conditions precedent to recovery from the bond. Indeed, Klochko voluntarily dismissed a garnishment proceeding against M & K when the direct payment plan was consummated.

Furthermore, it is clear the *Club Holding's* dicta that the Michigan Trust Fund Act does not apply to public projects were based on an assumption that any civil remedy provided by the statute would be in the nature of a mechanic's lien. 272 Mich. at 72, 261 N.W. at 135. Since it was, and is, "well-understood and established" that it is contrary to public policy to allow private liens on public property, the *Club Holding* court declined to recognize the civil remedy in a public property, the *Club Holding*, however, it has become apparent that the interest created by the Michigan trust statute is *not* a lien on property.[8] Rather it is an equitable interest in funds paid out by the owner and in no way encumbers

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[8] Selby, *supra;* National Bank of Detroit v. Eames & Brown, 396 Mich. 611, 242 N.W.2d 412 at 419 (Coleman, J. concurring) (1976); B. F. Farnell Co. v. Monahan, 377 Mich. 552, 141 N.W.2d 58 (1966).

the owner's property. Thus, the policy not to allow mechanics' liens on public property, which lay underneath the *Club Holding* and *General Insurance* dicta, does not apply to the Michigan Builders Trust Fund Act. Recognition of a civil remedy under the statute in a public project would in no way threaten to encumber the public owner's property. On the contrary, the trust fund act serves to prevent encumbrances of any kind because it is an alternative to the lien law.

Accordingly, the building construction funds due the bankrupt subcontractor in this case on both the private and public construction projects were subject to the Michigan Builders Trust Fund Act. The materialmen owned the equitable interests in the funds. These equitable interests were therefor not the property of the bankrupt subcontractor under § 70 of the Bankruptcy Act, and the payments to the materialmen within four months of bankruptcy were not preferential transfers under § 60 of the Bankruptcy Act. Consequently, the judgment of the district court must be reversed. Appellate costs are taxed against appellee.

LIVELY, Circuit Judge, dissenting. I respectfully dissent. The majority opinion seeks to avoid the impact of this court's decision in *General Insurance Company of America* v. *Tamar Corporation*, 482 F.2d 856 (6th Cir. 1973), by stating that the language in that opinion which holds the builder's trust act inapplicable to public projects was unnecessary to the decision. As I read *General Insurance Company* v. *Lamar Corporation*, its specific holding is the very language which the majority opinion treats as unnecessary.

The opening paragraph in *General Insurance Company of America* v. *Lamar Corporation* is:

> This appeal presents primarily the question whether under the Michigan Building Contract Fund Act of 1931, M.C.L.A. §§ 570.151 - 570.153, money paid to a contractor performing a public project constitutes a trust fund for the payment of subcontractors and materialmen for labor and material furnished on that project. We determine that it does not and reverse the judgment of the district court.
>
> 482 F.2d at 856-57.

After setting forth the facts of the case and noting that Michigan law applies, the court stated the issue as follows:

> The principal issue of Michigan law for our consideration is whether the Michigan Building Contract Fund Act applies to public as well as to private projects. 482 F.2d at 858.

The second issue in *General Insurance Company* (constructive trust), which the majority now says was sufficient basis for the decision, was never reached by this court. Indeed, the court stated, "Appellee does not press this theory on appeal, with good reason in our opinion, ..." 482 F.2d 861. This court decided but one question in *General Insurance Company* — that the Michigan builders' trust act does not apply to public projects. This decision was based upon a careful analysis of Michigan law which I consider sound.

The majority opinion states, "Michigan courts have not been called upon to rule upon the question of the applicability of the statute in the context of a public construction project." This may be literally true. However, in *National Bank of Detroit* v. *Earnes & Brown, Inc.*, 396 Mich. 611, 242 N.W.2d 412 (1976), the Supreme Court of Michigan quoted Judge McCree's language from *General Insurance Company* in describing the purpose of the builders' trust fund act. 396 Mich. at 619-620, 242 N.W.2d at 415-16. The Michigan court, after summarizing several of its own holdings then stated:

> The purpose of the Act is to create a trust fund for the benefit of materialmen and others under *private* construction contracts.
>
> 396 Mich. at 622, 242 N.W.2d at 417 (emphasis added).

I can perceive no valid reason or authority for departing from a holding of this court subsequently approved by the highest court of Michigan in a matter clearly controlled by Michigan law. I would affirm the judgment of the district court insofar as it holds that the Michigan builders' trust fund act has no application to public construction projects.

OPINION

(United States Court of Appeals
For the Sixth Circuit)

(Decided and Filed January 11, 1979)

RALPH I. SELBY, Trustee in Bankruptcy for the Frimberger Corporation, Plaintiff-Appellant, v. FORD MOTOR COMPANY, et al., Defendants-Appellees. (No. 76-1711)

On Appeal from the United States District Court for the Eastern District of Michigan.

Before: Weick, Edwards, and Merritt, Circuit Judges.

MERRITT, Circuit Judge. The trustee in bankruptcy for a general contractor appeals a decision by District Judge Joiner declining to set aside as preferences under § 60 of the Bankruptcy Act payments made by the contractor and by the owner of a construction project to subcontractors within four months of the general contractor's bankruptcy. The question on appeal concerns the recognition federal bankruptcy law should give to state-created property rights under the Michigan Builders Trust Fund Act.

The Michigan act creates a security device in the form of a "trust fund" for the benefit of the owner and subcontractors on construction projects:

> In the building construction industry, the building contract fund paid by any person to a contractor . . . shall be considered by this act to be a *trust fund*, for the benefit of [(1)] the person making the payment, [and (2)], contractors, laborers, subcontractors or materialmen, and the contractor . . . shall be considered the *trustee* of all funds so paid to him for building construction purposes.

Mich. Comp. Laws Ann. § 570.151 (1967) [Emphasis added.]

The purpose of the statute is to protect the owner and those whose labor and materials make the performance of a construction contract possible and give rise to the owner's obligation to pay.

The trustee in bankruptcy seeks to set aside payments to the subcontractors as preferential transfers under § 60 of the Bankruptcy Act. He wants to bring the funds into the bankrupt's estate to pay the general creditors. The subcontractors claim that the money paid to them constitutes the corpus of a trust which escapes the hands of the trustee. The district court ruled in favor of the subcontractors. 405 F. Supp. 164 (E.D. Mich. 1975). We affirm on grounds that a Michigan building contractor does not have sufficient beneficial interest in funds impressed with the statutory trust to constitute his "property" under the Bankruptcy Act. Therefore, the contractor's trustee in bankruptcy has no right to appropriate for the benefit of general creditors funds transferred to subcontractors by the contractor or the owner within four months of bankruptcy.

I.

On May 24, 1971, Frimberger Corporation filed in the federal court for the eastern district of Michigan a voluntary petition for an arrangement under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§ 722-23 (1976). A year earlier in the spring of 1970, Frimberger and Ford Motor Company had agreed in Michigan that Frimberger would build and install conveyors at a Ford plant in New Jersey. During the course of construction in the summer and fall of 1970, Frimberger employed the sixteen subcontractors who are defendants in this action. When the work was finished in the fall, Ford owed Frimberger approximately $355,000. Frimberger, in turn, owed most of this money to its sixteen subcontractors.

Instead of waiting to be paid by Ford before paying the subcontractors, Frimberger decided to authorize Ford to pay the subcontractors directly and to deduct this amount from Ford's indebtedness. Frimberger executed a series of written authorizations of December 8 and 15, 1970, and January 14 and 27, 1971, permitting Ford to pay all sixteen contractors directly. By February 11, 1971, Ford had issued checks to fourteen of the sixteen subcontractors. Frimberger itself paid the other two. Ford then paid Frimberger the remaining balance due on the construction contract. All sixteen of the checks to the subcontractors, both the fourteen drawn by Ford and the two by Frimberger were issued within four months of the filing of the petition in bankruptcy by Frimberger.

The trustee in bankruptcy filed this action against Ford and the sixteen subcontractors, seeking to recover the funds as preferential transfers within four months of bankruptcy under § 60a of the Bankruptcy Act, 11 U.S.C. § 96(a) (1976). The Trustee further claimed that Ford is liable for conversion of the bankrupt's property. Ford and the subcontractors denied liability for numerous reasons, including the claim that the payments could not be set aside even if preferential because the subcontractors held title to funds as trust beneficiaries under the Michigan Builders Trust Fund Act. The district court granted defendants' motions for summary judgment. The trustee in bankruptcy appeals.

II.

Neither the current Bankruptcy Act nor its legislative history addresses the question of how statutory trust funds held by a debtor for the benefit of others are to

be treated for purposes of the Act's "property,"[1] "preference,"[2] "priority,"[3] "statutory lien,"[4] or "discharge',[5] provisions. To unravel this question, we will look to the language and purpose of the Bankruptcy Act in relationship to property rights created under state law, the purpose of the Michigan statutory trust, the practices of the construction industry and the problems of the industry which the statutory trust was designed to remedy. We will also look to the new Bankruptcy Act and its legislative history to see if its treatment of statutory trusts should be used as persuasive authority.

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[1] Section 70 provides that the trustee in bankruptcy shall be "vested by operation of law with . . . title" to the "property" of the bankrupt. 11 U.S.C. § 110.

[2] Under § 60 the trustee in bankruptcy may set aside as a preference "a transfer . . . of any of *the property of a debtor* . . . for . . . an antecedent debt, made . . . while insolvent and within four months" of bankruptcy, the effect of which will enable the "creditor to obtain a greater percentage of his debt than some other creditor of the same class." 11 U.S.C. § 96(a)(1) [Emphasis added.]

[3] Section 64 establishes the priority of distribution of the assets of the bankruptcy estate to creditors. For example, the costs of administration are given first priority. Taxes are second; certain wages owed to employees are third. 11 U.S.C. § 104.

[4] Under § 67c(1), "statutory liens" (including mechanics liens) on a debtor's property are "invalid" against the trustee in bankruptcy unless "perfected" on the date of bankruptcy so that a bona fide purchaser of the assets subject to the lien could not acquire good title under state law. 11 U.S.C. § 107(c)(1).

[5] Section 17 provides that a "discharge in bankruptcy shall release a bankrupt from all his provable debts . . . except such as . . . (4) were created by his . . . misappropriation or defalcation while acting . . . in any fiduciary capacity." 11 U.S.C. § 35.

III.

Conceptually, the Michigan builders trust fund statute can be viewed in any one of three ways: (1) as imposing a traditional trust on the contractor's funds for the benefit of subcontractors, laborers and materialmen; or (2) as creating a security arrangement in the nature of a statutory lien; or (3) as creating no security or other interest recognizable under the Bankruptcy Act.

Viewed as a traditional trust, the beneficial interests in the trust fund would not be the "property" of the bankrupt contractor or his estate in bankruptcy. The subcontractors would own the beneficial title to the trust, and the contractor would simply hold legal title to the funds as trustee. Although the Bankruptcy Act does not deal expressly with trusts, the Supreme Court in an early case under the Bankruptcy Act of 1867 established that funds held in trust by a bankrupt debtor are immune from the claims of general creditors so long as the funds can be traced. *Hawkins* v. *Blake*, 108 U.S. 422, 435-36 (1882). This rule has not been changed by the current Bankruptcy Act, and the courts have continued to apply it. *See Pearlman* v. *Reliance Insurance Co.*, 371 U.S. 132 (1962); *First National Bank* v. *Staake*, 202 U.S. 141 (1905).

A statutory lien, on the other hand, is not effective against the claims of the trustee in bankruptcy unless it is perfected prior to the filing of the petition in bankruptcy. The lien is not perfected if, under state law, a bona fide purchaser would receive title superior to the lienholder upon transfer of the assets subject to the lien. A lien must be perfected by timely filing and adequate notice, and the time of perfection is defined by state statutory and case law. Statutory trusts,

however, arise automatically. No notice or filing is required, and perfection is beside the point. Under trust fund theory, a subcontractor's beneficial interest arises when the owner pays the building contract fund, even though a subcontractor cannot bring suit until the general contractor fails to pay a "matured" debt. *B. F. Farnell Co.* v. *Monahan*, 377 Mich. 552, 141 N.W.2d 58 (1966).

Although there is authority to the contrary with respect to statutory tax trusts,[6] the few cases on the question characterize other statutory trusts as traditional trusts for purposes of bankruptcy.[7] Commentators have criticized this result, however. They say that statutory trusts should be treated as statutory liens because statutory trusts function as a security device, and "the application of a national bankruptcy statute to legal interests diversely defined" by the states requires

[6] *United States* v. *Randall*, 401 U.S. 513 (1971) and *England* v. *United States*, 546 F.2d 821 (9th Cir. 1976), *cert. denied*, 431 U.S. 974 (1977), appear to hold that tax trusts established by statute in favor of federal or state taxing authorities are subject to § 64 of the Bankruptcy Act, the priority section. This section gives tax creditors second priority after the payment of costs of administration of the bankrupt's estate. These cases hold that any attempt to give tax creditors trust beneficiary status conflicts with the priority scheme of § 64. In the instant case, however, there is no legislative indication that building construction funds held in trust under state law should be considered a general asset of a bankrupt's estate. These cases have apparently been modified or overruled by the new Bankruptcy Act. *See* note 18 *infra*.

[7] Carrier Corp. v. J. E. Schecter Corp., 347 F.2d 153 (2d Cir. 1965) *(semble)*; Wickes Boiler Co., Inc. v. Godfrey-Keeler Co., Inc., 116 F.2d 842 (2d Cir. 1940), *mod. on reh.* 121 F.2d 415, *cert. denied* 314 U.S. 686 (1941); Elliott v. Bumb, 356 F.2d 749 (9th Cir. 1966).

classification "on the basis of function rather than nomenclature."[8] But no cases have adopted this approach, and this criticism overlooks the traditional role of the states in creating and defining the underlying property interests and commercial arrangements to which the Bankruptcy Act applies.[9]

Though *Aquilino* v. *United States*, 363 U.S. 509 (1960), is not a bankruptcy case, the Court's reasoning is on point. Subcontractors under New York's builders trust fund statute claimed money paid by the owner to a general contractor. The United States also claimed the funds under a perfected federal tax lien. The New York Court of Appeals ruled in favor of the government, apparently on the ground that federal tax liens take "precedence" over statutory trusts as a matter of federal tax law.

The Supreme Court reversed and remanded. It held that the question of priority depends upon the "rights created under state law" by the statutory trust. Chief Justice Warren rejected the government's argument that "the definition of the taxpayer's property interests should be governed by federal law" because that

[8] Note, *The Statutory Trust Fund in Bankruptcy*, 50 Yale L.J. 1268, 1271 (1941). *See also* 4 Collier, Bankruptcy, Paragraph 67.25[2] (14th ed. 1974) ("statutory trust is no more than a legislative device to protect a particular class of creditors" and should be treated as a statutory lien under § 67).

[9] Chicago Board of Trade v. Johnson, 264 U.S. 1, 10 (1923) ("where the bankruptcy law deals with property rights which are regulated by the state law, the federal courts in bankruptcy will follow the state courts"); Eaton v. Boston Trust Co., 240 U.S. 427, 429 (1916) ("the policy of the Bankruptcy Act is to respect state exemptions").

argument "ignores the long established role that the States have played in creating property interests and places upon the courts the task of attempting to ascertain a taxpayer's property rights under an undefined rule of federal law." 363 U.S. at 513 n.3. With these instructions from the Supreme Court, the New York Court of Appeals, on remand, in an opinion by Chief Justice Fuld, reversed its previous position. It found that under state law,

> there is no good reason to suppose that the legislature by declaring payments to a contractor to be "trust funds," did not intend thereby to avoid the very same possibilities of harm to the statutory beneficiary as was intended by the rule against diversion of funds of an express trust . . . . Our conclusion, then, is that . . . a contractor does not have sufficient beneficial interest in the moneys, due or to become due from the owner under the contractor, to give him a property right in them, except insofar as there is a balance remaining after all subcontractors and other statutory beneficiaries have been paid. This being so, it follows that the tax lien herein asserted by the Government . . . is ineffective to reach such moneys . . . .

10 N.Y.2d 271, 279, 176 N.E.2d 826, 831-32 (1961).

We believe that this reasoning applies to the treatment of statutory builders trusts under the Bankruptcy Act. Under Michigan law, the Builders Trust Fund Act creates a private, civil action in favor of the beneficiaries of the statutory trust, *National Bank of Detroit*, v. *Eames & Brown*, 396 Mich. 611, 242 N.W.2d 412 (1976). Michigan courts have also determined that,

to the extent state law controls the federal question, the beneficial interests of subcontractors and materialmen under the statutory trust are not the "property" of the bankrupt debtor or his trustee in bankruptcy under § 70 of the Bankruptcy Act. *B. F. Farnell Co.* v. *Monahan*, 377 Mich. 552, 141 N.W.2d 58 (1966). We agree with the Michigan courts and believe that federal bankruptcy law should recognize and enforce the property rights created by state law under the Michigan statutory trust.

IV.

There are additional reasons to resolve the federal question under the Bankruptcy Act in favor of recognition of these state-created property rights. The Michigan Builders Trust Fund Act was passed prior to the restrictions placed on statutory liens under the 1938 revision of the Bankruptcy Act. It was framed for legitimate reasons of state law and not to undermine the Bankruptcy Act. We do not believe that the statutory trust should be construed in substance as creating a statutory lien or as an evasion of the property and preferential transfer provisions of §§ 70 and 60 of the Bankruptcy Act.

The Michigan Builders Trust Fund Act is designed to remedy problems in the construction industry. Like the law merchant of an earlier day, the building trades have gradually created a set of commercial expectations as the result of the customs and practices of the industry. The nature of the industry is such that the commercial expectations of the parties are defeated when a building contractor or subcontractor does not use accounts paid to him on a job to pay subcontractors or materialmen. Unless the parties see that construction funds are

properly applied down the line, the liabilities of the parties up the line are affected. The unpaid workers must undertake the lengthy and wasteful process of filing, perfecting and foreclosing on their mechanics liens. The owner's property and the construction lender's security are encumbered.[10]

The statutory builders trust is not simply special legislation that the building trades have lobbied through state legislatures. Its justification is that the contractor, subcontractor and materialmen cannot spread their risks in the same way as the grocer or other merchants with many customers. Large quantities of labor and materials may go into a single construction project over a long period of time. A large part of a tradesman's capital may be tied up in a small number of construction projects. There is a substantial risk that a general contractor who goes bankrupt will pull down with him some of his subcontractors and materialmen, as well as cause serious economic loss to the owner.[11]

The construction lender, owner, disbursing agent, contractor, subcontractor or surety company which furnishes a payment bond may not have a direct contractual relationship with a materialman down the line. But courts and legislatures have increasingly found

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[10] For further discussion of the Michigan Act as "one of a genre of Depression-era measures intended to afford relief . . . in the construction industry," *see* General Ins. Co. v. Lamar Corp., 482 F.2d 856, 860 (6th Cir. 1973); National Bank of Detroit v. Eames & Brown, 396 Mich. 611, 242 N.W.2d 412, 415-16 (1976).

[11] *See* the *General Insurance* and *National Bank of Detroit* cases, *supra* note 10; N. Penney & R. Broude, Land Financing 658 (1970).

that the parties have an independent legal duty arising from reasonable commercial expectations to see to the proper application of construction funds.[12] In the absence of statute, courts have declared that construction funds in the hands of a contractor are held subject to a constructive trust or an equitable assignment or an equitable lien.[13] Even in the absence of a state builders trust statute, federal bankruptcy courts in a variety of situations have refused to apply the property, preference and statutory liens sections of the Bankruptcy Act to favor unsecured creditors over the equitable claims of subcontractors and materialmen to the proceeds of a construction project in the hands of a bankrupt contractor.[14]

State builders trust statutes simply recognize in statutory form the principles embodied in these court decisions. The remedies provided by mechanic's lien laws are unsatisfactory,[15] and state legislatures in a

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[12] *See, e.g.*, Michigan's payment bonding statute, Mich. Comp. Laws Ann. § 129.207 (1967); The Miller Act, 40 U.S.C. § 270a-f (1976); Jackson v. Flohr, 227 F.2d 607 (9th Cir. 1955), *cert. denied* 350 U.S. 947 (1956). *See generally* Annot. 26 A.L.R. Fed. 746 (1976); Annot. 62 A.L.R.3d 288 (1975).

[13] Johnson v. Root Mfg. Co., 241 U.S. 160 (1914); Mikelson v. Aetna Casualty & Surety Co., 452 F.2d 1219 (8th Cir. 1971); Carrier Corp. v. J. E. Schecter Corp., *supra* note 7; American Service Co. v. Henderson, 120 F.2d 525 (4th Cir. 1941).

[14] Keenan Pipe & Supply Co. v. Shields, 241 F.2d 486 (9th Cir. 1956); Mullins v. Roland Co., 406 F.Supp. 206 (N.D. Ga. 1975); Stone v. Mondie, 157 F.Supp 929 (W.D.Okla. 1957).

[15] *See* General Insurance and National Bank of Detroit, supra note 10.

number of states, like Michigan, have adopted builders trust fnd statutes. The property rights created by these state statutes should be recognized and enforced in the bankruptcy system. The trustee in bankruptcy should not be permitted to appropriate the trust of another and distribute it to the bankrupt's creditors.

V.

We draw support for our position from the new Bankruptcy Act, as well. The new Act, signed by the President on November 6, 1978,[16] expressly recognizes trust interests created under state law. Section 541, the "property" section of the new law, provides that the bankruptcy estate shall include "all legal and equitable interests of the debtor in property." But it limits the interests of the trustee in bankruptcy to § 541(c)(2), "a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case" in bankruptcy.

In addition, the Senate Report on the new Bankruptcy Act and the statements of the floor managers of the Act in both the House and the Senate demonstrate that the Bankruptcy Act "will not affect various statutory provisions . . . that create a trust fund for the benefit of a creditor of the debtor."[17] The Senate Report and the

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[16] P.L. 95-598 95th Cong., 2d Sess., set out in the "Statute" section of the Nov. 14, 1978 edition of *Law Week*, 47 U.S.L.W. 1.

[17] S.Rep. 989 at 82, 95th Cong., 2d Sess. (1978); 124 Cong. Rec. S17.413 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); 129 Cong. Rec. H11,096 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards).

floor managers cite several examples of statutory trust funds. They cite statutes impressing a trust on withholding and other taxes in the hands of the employer or person who collects the tax for state or federal governments.[18] They also cite the federal statutory trust created in favor of farmers who sell livestock to meat packers under the Packers and Stockyards Act § 206, 7 U.S.C. § 196 (1976). The legislative purpose is clear. Statutory trust funds are not the property of the debtor and are not subject to the statutory lien (§ 545) and preference (§ 547) provisions of the new Act.

In view of the fact that the current Bankruptcy Act is silent on the subject of statutory trusts, we believe that it is proper to use the new Act as persuasive authority in interpreting the old. Under both Acts, a state statute creating a builders trust fund should be given effect in bankruptcy. The beneficial interests of subcontractors and materialmen in a building fund should not be regarded as the property of the bankrupt debtor, at least so long as the beneficial interests are traceable. In the

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[18] According to this legislative history, it appears that § 541 of the new Act intends to modify or overrule the holdings in the *Randall* and *England* cases, *supra* note 6. 124 Cong. Rec. S17,436 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); 124 Cong. Rec. H11,114 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards).

instant case tracing creates no problem. The funds subject to the statutory trust were paid to the subcontractor as trust beneficiaries prior to bankruptcy.[19]

Accordingly, the judgment of the District Court is affirmed. Costs of appeal are taxed against Appellant.

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[19] There is no claim in this case that Ford and Frimberger preferred or unfairly advanced trust funds to some subcontractors on the job at the expense of others. The trustee seeks to recover funds from the subcontractors for distribution to the unsecured creditors, not for distribution to unpaid beneficiaries of the statutory trust. We need not decide in this case what power the trustee has to recover payments made to favored subcontractors when the building trust funds have been exhausted and some subcontractors have been left unpaid.

OPINION

(United States of America
United States District Court
For the Eastern District of Michigan
Southern Division)

OLYMPIA CONSTRUCTION COMPANY, Appellee, vs MARIO TRUCKING CO., KLOCHKO EQUIPMENT CO., PRICE BROTHERS, AND DOUG SCHROEDER, Appellants. CA No. 74 60440

OPINION RENDERED FROM THE BENCH, in the above-entitled matter, by the Hon. JAMES HARVEY, Judge, United States District Court, at Flint, Michigan, on Wednesday, July 28, 1976.

APPEARANCES: CROSS, WROCK, MILLER & VIESON, 4200 Penobscot Building, Detroit, Michigan, 48226; BY: ANDREW PATTERSON, ESQ., Appearing on behalf of the Trustee.

STEPHEN G. DANKO, ESQ., 12154 Dix-Toledo Road, Southgate, Mich., 48195, Appearing on behalf of Appellant Mario Trucking.

LANGS, SCHATZBERG, PATTERSON & LANGS, 2700 Guardian Building, Detroit, Mich., 48226
By: RICHARD LANGS, ESQ., Appearing on behalf of Appellant Klochko Equipment.

JAMES E. WYSZYNSKI, Official Court Reporter

DAVIS, HAYWARD, HERTLER, JONES & KINGSEPP, 3101 No. Woodward Ave., Suite 300, Royal Oak, Mich., 48072; By: JON H. KINGSEPP, ESQ., Appearing on behalf of Appellant Price Brothers

HARRIS, BEN & MARCKS, 2133 Cadillac Towers, Detroit, Mich., 48226; By: MARYLNN MARCKS, ESQ., Appearing on behalf of Appellant Doug Schroeder.

Flint, Michigan
Wednesday, July 28, 1976

* * *

(3) The Court: First, the Court will note for the record that there are issues of fact and law that are common to these appeals and for this reason the Court has consolidated its Opinion and will not present a separate Opinion for each appellant.

The matter to be decided in each case is whether the creditor received a preference within the meaning of Sec. 60(a) of the Bankruptcy Act.

Appellant Doug Schroeder, Inc., raises five issues.

First, whether there was a transfer of the bankrupt's property;

Second, whether any transfer of the property was payment for, or on account for, an antecedent debt;

Third, whether the bankrupt's estate was depleted by such a transfer;

Fourth, whether the bankrupt was then insolvent, and;

Fifth, whether appellant had constructive knowledge of the bankrupt's insolvency.

(4) Appellant Mario Trucking Company raises the same issues.

Appellant Klochko Equipment raises the same issues but, in addition, claims that any transfer of property was not within four months of the bankruptcy and claims that the Referee committed error in the re-opening of the Trustee's case.

Finally, Appellant Price Brothers raises the same issues but claims, in addition, that it was a secured creditor because of the Notice it filed with the contractor.

The Court has carefully considered the record in each case and finds that the Referee's findings of fact are not clearly erroneous. Therefore, the Court will reaffirm the findings that the payment was on account for an antecedent debt;

That the payment depleted the bankrupt's estate;

That the bankrupt was then insolvent, and;

That the creditor had constructive knowledge of the insolvency.

The Court also finds from a review of the record in these cases that there are no procedural errors. The form of evidence; the credibility of witnesses and the (5) issues raised by Klochko Equipment regarding the re-opening of the record, are all matters addressed to the discretion of the Bankruptcy Court and this Court finds that that discretion has not been abused.

The central issue in each of these appeals — and let me say it is an issue of law — is whether the bankrupt held a property interest in the check issued jointly to it and a creditor.

It is undisputed that the check in each case represented funds owed by the bankrupt to the creditors.

It is also undisputed that the check was paid out of funds owed by the contractor to the bankrupt.

The Court finds that such a transfer from a contractor to a sub-contractor and creditor of the bankrupt involving work performed on a public project is a transfer of the bankrupt's property within the meaning of Sec. 60(a) of the Bankruptcy Act. The general rule is that any chosen action of the bankrupt is property of the bankrupt. The Court cites in that regard its Opinion in *Atlas Concrete Pipe v Rocco Perrera*, found at *409 F Supp, 1364*, a 1975 decision.

The same principle applies to these appeals.

The contractor was not holding this money in trust as appellants would argue, since the Trustee (6) theory in Michigan, MCLA 507.151, does not apply to public projects. The Court will cite in that regard the decision of the Sixth Circuit in *General Insurance Co. of America v. Lamar Corporation, found at 482 F 2d. 856*, being a 1973 case and *Beiter v. Kuhlman, 59 Mich. App., 54*, and note particularly page 57, a 1975 case. Further, the decision by this Court in the appeal of *Able Rental Service*, in this case.

Since the property being transferred was that of the bankrupt's, it makes no difference that the transfer was completed through a third person. The Court cites in that regard *Steel Structures, Inc. v Star Manufacturing Co., 466 P 2d, 207*, the same being a Sixth Circuit decision dated 1972.

The next issue raised by the Appellant Price Brothers is as to whether it was a secured creditor because it had complied with the statutory notice requirements of MCLA 129.201, and those sections following.

The Court finds under MCLA 129.207 that the contractor was not obliged to make payments directly to the material man so that no security interest was acquired and the bankrupt at all times retained its interest in the receivables.

In regard to the Garnishment lein filed by Klochko Equipment, the Court agrees with the Trustee's construction of Federal Rule 6(a) when applied to Sec. 60(a) (7) of the Bankruptcy Act, which means that this lein could also be set aside on the grounds that it was acquired within four months of the bankruptcy. The Court also finds that the lein was never perfected and if it had been, the Court would have had to set the same aside as being illegal and the Court cites in that regard *Fuentes v. Shevin, 407 U.S., 67*, the same being a 1972 case.

For all these reasons, the Court hereby affirms the respective decisions of the Bankruptcy Court and the Court will sign individual orders to that effect as they pertain to each appellant.

This concludes the Court's ruling.

State of Michigan
County of Genesee—ss.

I hereby certify that I reported in stenotypy the proceedings had in open court in the above-entitled matter before the Honorable JAMES HARVEY, Judge, United States District Court, at the time and place hereinbefore set forth; that the Opinion portion thereof was thereafter reduced to typewritten form by me or under my supervision, and that the foregoing transcript is a full, true and correct transcription of my stenotype notes.

/s/ JAMES E. WYSZYNSKI,
Official Court Reporter

OPINION and ORDER

(United States District Court
(For the Eastern District of Michigan
Southern Division)
(In Bankruptcy)

(Filed)

In the Matter of Olympia Construction Company, a Michigan Corporation, Bankrupt, Robert E. Parker, Trustee in Bankruptcy, Plaintiff, vs Klochko Equipment Rental Company, Inc., a Michigan Corporation, Defendant. No. 74-60[illegible]

On September 12, 1974 the trustee, Robert E. Parker, filed a complaint to recover a preference from the defendant, bringing the action under Section 60 of the Bankruptcy Act.

Findings of Fact

Olympia filed a voluntary petition in bankruptcy December 21, 1973. On September 11, 1973 the bankrupt transferred the sum of $20,000 by check (Exhibit #2) to or for the benefit of the defendant, a creditor, by obtaining from Markward & Karafilis, hereinafter referred to as M & K, the prime contractor, a check from M & K drawn on an account owed by M & K to Olympia. The check from M & K was preceded by a garnishment filed by the defendant Klochko against the account owed by M & K to Olympia (Plaintiff's Exhibit #4). The Writ of Garnishment stated that the defendant had commenced an action against Olympia claiming $21,121.68 and was dated August 16, 1973, plaintiff's attorney being Richard J. Langs.

Subsequently, the garhishee defendant, M & K, settled the garnishment by paying the defendant the sum of $20,000 for which the defendant agreed to release M & K and look to the bankrupt for the balance.

The affidavit for the Writ of Garnishment (Exhibit B) filed by the defendant and signed by Richard J. Langs states:

> "And this deponent further says that he is justly apprehensive of the loss of said sum so due to the said plaintiff from said defendant, unless a Writ of Garnishment is issued since without it the defendant may at any time release, claim, remove, and secret or transfer and dispose of the aforesaid indebtedness, money, goods, chattels, credits, negotiable instruments and effects, thus making it unavailable to the satisfaction of plaintiff's judgment."

On September 18, 1973, a Stipulation to Dismiss Ancillary Garnishment Action and Release Garnishee Defendant From Liability was filed in the Circuit Court for the County of Livingston in Civil Action No. 2313 in which Klochko Equipment Rental Company appears as plaintiff and Olympia Construction Company appears as defendant. The stipulation was signed by Richard J. Langs. An Order of Dismissal, re the above action, was filed on September 18, 1973 releasing M & K from further liability in relation to the ancillary garnishment. (Exhibit D)

On November 30, 1973 Klochko took a default judgment against Olympia in the amount of $1,121.68 which was the balance owing to Olympia by M & K after M & K issued its check for $20,000 to the defendant Klochko and debited its account owing to Olympia in a like amount. (Bankrupt's Exhibit #2)

Plaintiff introduced Exhibit #6, an account ledger of the transactions between the bankrupt and the defendant. Exhibit #6 shows a first entry dated 11/30/72 which was a charge in the amount of $2,512.26 which was paid 12/22/72, and from thereon the record indicates a constantly increasing indebtedness of the bankrupt to defendant with the last credit being 5/1/73 which brought the account down to $17,085.67. This was the last payment made by Olympia on the account except for July 1973 when a total credit of $3,000 was given for, as I recall, return of equipment. On June 29, 1973 the balance on the account owed to the defendant was $20,859.93 and on July 27, it was $24,121.68 which was the last transaction of business between the parties.

Billings were made on a 30 day net basis.

The payment made in May of 1973 by Olympia to the defendant was on account of an invoice dated 2/28/73.

The Affidavit of Richard J. Langs, (Exhibit #7,) states that on August 16, 1973 Neil Peffer, Office Manager of Klochko forwarded to him documents evidencing a debt from Olympia to Klochko and he then prepared and filed in the Livingston Circuit Court a Complaint against Olympia (the bankrupt) which he filed in the Livingston Circuit Court and he personally went to the office of M & K during the lunch hour on August 20, 1973 and served the Writ on M & K.

The Affidavit further states that before a disclosure was made he received a call from George Peck, treasurer of M & K, suggesting that M & K would like to get the garnishment released and subsequently the parties agreed upon a total payment of $20,000 to release the garnishment and hold M & K harmless on any balance.

The Affidavit further states that subsequently he pursued the balance of Klochko claim against Olympia to judgment in Livingston County Circuit Court on November 30, 1973 when a default judgment of $1,121.68 plus interest of 1½% a month from February of 1973 was entered against Olympia.

Findings of Law

The elements of a preference under Section 60 consist of the following:

> "A debtor (1) making or suffering a transfer of his property, (2) to or for the benefit of a creditor, (3) for or on account of an antecedent debt, (4) while insolvent, and (5) within four months of bankruptcy, (6) the effect of which transfer will be to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class (7) the creditor receiving or to be benefited by the preference has reasonable cause to believe that the debtor was insolvent." *Vol 3, Collier, Sections 60.02, p. 758-59.*

1. As to the First Element

Exhibit #2, a check in the amount of $20,000.00 payable to Olympia Construction Company and Klochko Equipment Rental Company, was paid by Markward & Karafilis, Inc. as the result of the garnishment to Olympia by M & K. Exhibit #2 was endorsed as follows:

> Olympia Construction Co
> Michel J. Pricer
> Vice President

The payment reduced the assets of Olympia by $20,000 and paid approximately 95% of the claim that Klochko had against the bankrupt.

Plaintiff has proved the elements of No. 1.

2. *As to the Second Element*

The record clearly proves by virtue of Exhibit #2, the check, Exhibit #1, a letter from Mr. Langs to Mr. George Peck of M & K dated September 13, 1973, acknowledging the receipt of the $20,000 check, Exhibit #7, the Affidavit of Richard J. Langs wherein he agreed to release the garnishment for an immediate payment of $20,000 from Mr. Peck and the acknowledgment that the $20,000 was given to him on September 11, 1973, the Stipulation to Dismiss the Ancillary Garnishment, Exhibit C, and the Order of Dismissal of the Ancillary Garnishment, Exhibit D and the Default Judgment, Exhibit E, judgment taken November 30 for the balance of the Klochko claim of $1,121.68, that indeed the defendant did receive payment in the amount of $20,000.

Plaintiff has proved element No. 2.

3. *As to the Third Element*

Exhibit #6 shows that the last charge made by the defendant against Olympia was dated July 27, 1973. The date of payment on the account was September 11, 1973. Clearly the debt was an antecedent one in contemplation of Section 60. *Cooper Petroleum Company 379 F2d 777*

Clearly the plaintiff has proved element No. 3.

4. *As to the Fourth Element*

Plaintiffs introduced in evidence the bankruptcy schedules of the bankrupt which showed on the date of adjudication the debts to be $416,600.01 and the assets to be $45,885.00. Plaintiff called as his witness the bookkeeper of the bankrupt who had been such from the inception of the business. She testified that she was thoroughly familiar with the books and records of the bankrupt and that they were kept under her control, and that the assets and liabilities as shown on the schedules of the bankrupt were substantially the same at a four month period pre-dating the filing of the bankruptcy. Referring to the Statement of Affairs of the bankrupt the schedules indicate that no property was transferred by the bankrupt in the twelve months preceding bankruptcy.

Clearly, the plaintiff has proved that on the date of transfer the bankrupt was insolvent.

5. *As to the Fifth Element*

Exhibit #2 shows the payment to defendant to be September 11, 1973, which would be well within the four month period contemplated by Section 60.

Clearly, the plaintiff has proved that the transfer of the $20,000 complained of occurred within four months preceding bankruptcy.

6. *As to the Sixth Element*

On the date of the transfer, according to the record, the bankrupt owed $21,121.68 to the defendant. By receiving $20,000 of the amount owed the defendant

received approximately 95% of its claim against the bankrupt. The defendant was a general creditor and the bankruptcy schedules indicate that the bankrupt owed general creditors approximately *$98,054.00* on the date of the transfer. If all of the assets could be distributed to the general creditors on a pro-rata basis, and there were no secured creditors to deal with, and no expenses of administration were allowed, the general creditors would get *20%* of their claims against the bankrupt.

Clearly, the plaintiff has proved the 6th element.

7. As to the Seventh Element

Did the defendant have reasonable cause to believe that the bankrupt was insolvent at the time of transfer?

As might be suspected, a substantial amount of case law has developed over this troublesome seventh element. As the author points out in Cowans Bankruptcy Law and *Practice, Section 752, p 401*:

> "Seldom is any single factor considered determinating of reasonable cause to believe. It is thus difficult to point to single factors.
>
> Experienced counsel know that it is seldom an easy burden to make a case out of the knowledge or experience of the opposing party."

What an incongruous position Congress has imposed upon creditors who receive payment of antecedent debts within four months of bankruptcy; an obligation to return such amounts to the bankrupt's estate if the creditor had, at the time of transfer, a reasonable cause to believe the debtor then insolvent, and if, indeed, the debtor was insolvent.

Section 60 was enacted to carry out the congressional intent in creating the Bankruptcy Act of providing that the bankrupt's property would be paid pro-rata to all general creditors. In order to prevent raids on the bankrupt's property by knowledgeable and informed creditors, and prevent payment to favored creditors, Congress provided that any payment on an antecedent debt within four months of the date of adjudication would violate the equal distribution of assets theory and hence should be repaid to the bankrupt's creditors through the trustee. That would seem to carry out the congressional intent in a reasonable manner, but unfortunately, Congress added that in order to subject a creditor to the recovery of the funds by the trustee, the trustee must show that the creditor had reasonable cause to believe the bankrupt insolvent at the time of the transfer.

Presumably, if a creditor were to meet the requirements of Sec. 60, and he had any indication that the debtor might be insolvent at the time he was tendered the amount of the debt by the debtor, he should either refuse it, which is unthinkable, or make inquiry as to whether the debtor was indeed insolvent.

If the creditor did find insolvency, then the creditor should refuse payment, or surrender such to the trustee if bankruptcy ensured within four months of payment. I have never heard of such a voluntary return of money to the trustee. Sec. 60 was enacted to compel such a legal duty.

As a matter of public policy, to carry out the intent of Congress for equal distribution, Section 60 relating to preferences should be liberally construed in favor of

recovery of payments made within four months of bankruptcy on an antecedent debt. It is quite clear that the Courts have done this. In the case of *C.A. Swanson and Sons vs Wilie, 237 F2d 16*, the court said:

> "The creditor need not have actual knowledge of debtor's insolvency."

In the cases of in re *States Printing Co., 238 F755, McDougal vs Central Union Conference, 110 F2d 939*, the Court said:

> "Nor need l.e actually believe him to be insolvent."

In the case of *Salter vs Guarity Trust Co., 237 F2d 446*, the court said:

> "The creditors action will be taken as evidence of his beliefs, however.
>
> Few courts will permit a creditor to say that even though it appears from the facts that he did believe the debtor to be insolvent, that the Court should pay no attention to this because he was acting unreasonably in his beliefs."

The test is somewhat an objective one in the courts consideration of the question of fact.

In the case of in re *Cox 132 F2d 881*, the Court said:

> "One has reasonable cause to believe one's transferor is insolvent when a reasonable person in possession of the facts known or evident to the creditor would believe him insolvent."

In the same case the Court held:

> "The creditor may not escape the effect of facts he already knew. If he knew enought to put him on inquiry as a reasonable man, it was necessary for him to make the inquiry."

In the case of *Security First National Bank vs Quittner, 176 F2d 997; Marks vs Goodyear 238 F2d 533; Mizell vs Phillips, 240 F2d 738; Grandeson vs National Bank, 231 F800; Cert. denied. 242 U.S. 644.*

> "He is responsible for what the inquiry would have revealed."

In the case of *Gering vs Layda, 186 F 110; McGir vs Humphreys, 192 F55*, the Court held:

> "The inquiry required of one in determining insolvency may not safely be confined to discussing the matter with the bankrupt who may be a dubious source of information."

According to the test applied by the Courts, if the respondent creditor had grounds exciting his suspicion as to whether or not the bankrupt was insolvent at the time of the transfer, the creditor is bound to make an investigation before accepting the transfer of funds, and if the creditor does not make the investigation, he is nonetheless bound by what he might have found if he had. Exhibit B, the Affidavit of Garnishment executed by Mr. Langs on behalf of his client Klochko Equipment Rental Company, sufficiently states an apprehension on the part of the defendant that without the aid of the garnishment of the funds held by M & K the creditor might indeed go unpaid.

The record indicates that on August 16, 1973 the documents evidencing a debt from the bankrupt to Kochko were mailed by Mr. Peffer, Office Manager of the defendant to Mr. Langs and Mr. Langs took precipitous action. The Affidavit of Garnishment was

sworn to on August 15 and the Garnishment was served personally by Mr. Langs on August 20. The garnishment action itself is a rather precipitous and hard-handed means of dealing with a customer. The connotation would be that either the debtor refused to pay the bill or was unable to do so. In this case, the record indicates from the testimony of Mrs. Voorhies that there was a willingness to pay but that the bankrupt could not. The garnishment, of course, under the circumstances, was justified, and the evident suspicions of the defendant creditor were also justified. The substance of Mr. Langs Affidavit was undoubtedly obtained from his client, the defendant. He was apprehensive that the account would not be paid because his client undoubtedly advised him to that affect. His knowledge is imputable to his principle, Klochko.

Mr. Peffer, who was called by plaintiff's counsel, testified that he made telephone calls to the bankrupt during July and August and then because the bill was not paid, he turned the account over to Mr. Langs for garnishment procedures. He testified:

> "In the light of conflicting statements from Olympia and K & M, I decided to send the account to Mr. Langs."

He testified further that he had several telephone conversations with an employee of Olympia by the name of Mike who promised payment by certain dates on account and the payments received were not in the amount as promised. The excuse for this, was that Olympia was having difficulties collecting from M & K. He then stated that he talked with someone at M & K and M & K advised the witness that M & K was making payments to Olympia and Olympia should have the money to pay.

The deposition of George Peck, former treasurer of M & K was read into the record. He testified that he dealt with Mr. Voorhies at Olympia concerning the account, and on page 13 of the deposition stated:

> "We eventually realized that Olympia had a financial problem, due to the fact that we were being contacted by numerous debtors."

On page 14 stated that:

> "I met Voohies, of Olympia, at the M & K offices several times to talk over the financial situation."

On page 15 testified that:

> "I became concerned about the ability of creditors to furnish them equipment and materials."

These concerns of the witness and the knowledge that he has testified to is imputable to his principal, the defendant.

It is the conclusion of this Court that the record discloses abundant evidence that the defendant creditor was apprehensive concerning the ability of the bankrupt to pay its debt.

Under the authorities cited the defendant is charged with what it would have determined had it made then an investigation of the financial condition of the bankrupt. Within the four month period, the defendant creditor would have found that the bankrupt was insolvent and was insolvent at the time the payment was made to him.

This court will hold that element No. 7 has been proved by the plaintiff.

Garnishment

The defendant contends that it perfected a lien by garnishment before the four month period preceding bankruptcy and hence that Section 60 of the Bankruptcy Act would have no applicable force.

The record shows that the garnishment was served on the garnisheed defendant on August 20, 1973 and that the date of adjudication was December 21, 1973. The rule for computation time is expressed in *U.S. vs Young 376 F. S. 1290,* and it is clear that the computation of time does not begin until the day after the event. The running of the time of the garnishment would begin on August 21 and 120 days expiring would bring it on December 21. This would be within the four months period prior to bankruptcy.

However, the issue of the effect of the garnishment as a lien under the circumstances herein has already been passed upon in the case of *Douglas Research and Chemical, Inc. vs Solomon,* a case heard before Honorable George C. Edwards, Jr., United States Court of Appeals Judge, the Honorable John Feikens and the Honorable Charles W. Joiner, United States District Judges sitting in Detroit, Michigan. The opinion of the Honorable Charles W. Joiner held that the Michigan Garnishment law was invalid because it violates due process as defined in the case of *Fuentes vs Shevin, 407 U.S. 67.* The Douglas Research and Chemical case is as yet unreported to my knowledge.

The record in this case would indicate that the defendant herein resorted to prejudgment garnishment and hence the claimed lien would be invalid. Other cases which have ruled on the matter of prejudgment

garnishment statutes are *Sniadach vs Family Finance, 395 U.S. 335, Larson vs Featherstone, 44 Wis. 2d 712, 172 N.W.2d, Jones Press, Inc., vs Motor Travel Service, Inc., 176 N.W.2d 87; Randon vs Appellate Court of California, 488 P2d 13.*

The Michigan Court of Appeals quoting Sniadach and Fuentes, supra has declared the Michigan replevin statute unconstitutional for the same principle of law. *Motor Sales vs Judge of the Common Pleas Court, 42 Mich. Appeal 112.*

There being no lien on which the defendant can rely, the transfer occurred on the date the funds were delivered to the defendant.

Although the Court does not recall the parties raising the issue of invalidity of the garnishment for lack of due process, the Court may support its order on any ground which the record justifies. In re *Loresh 117 F2d 612.*

Likewise, the claimed lien would appear to be invalid under Sec. 67 a(1), and although the defendant argued that the transfer of the funds through a third person was property which never became part of the bankrupts assets, a creditor may not do by indirection what he is prohibited from doing by direction. *Steel Structures vs Star Manufacturing 466 F2d 207.*

Order

The transfer in the present case meets all the requirements of Section 60, the preference statute. The payment was made within four months of bankruptcy on account of an antecedent debt; the bankrupt was insolvent at that time; the property transferred belonged

to the bankrupt; the effect of the transfer was to enable the defendant to obtain a greater percentage of its claim than other creditors of the same class; the creditor defendant had a reasonable cause to believe that the bankrupt was insolvent at the time the transfer was perfected. The sole purpose of the transaction was to require Olympia, the bankrupt, to pay Klochko, an unsecured debt, all the parties to the transaction knew this to be true. The payment diminished the assets of Olympia in like proportion, and every general creditor, in effect, would be an unwilling and unknowing contributor.

The trustee shall have and does, a judgment against defendant in the amount of $20,000.

/s/ Harold H. Bobier
Bankruptcy Judge
Eastern District of Michigan

Dated: 9/5/1975

JUDGMENT ORDER

(United States District Court
Eastern District of Michigan
Southern Division)

(Filed June 20, 1975)

In re: OLYMPIA CONSTRUCTION COMPANY, a Michigan corporation, Bankrupt: ROBERT E. PARKER, Trustee in Bankruptcy, Plaintiff, vs. MARIO TRUCKING CO., a Michigan Corporation, Defendant. Bankruptcy No. 74-60440.

At a session of said Court held in the Federal Building, Flint, Genesee County, Michigan, on the 24th day of June, 1975.

PRESENT: HONORABLE HAROLD H. BOBIER,
Bankruptcy Judge.

This matter having come on to be heard and tried by the Court, and testimony having been taken, argument having been heard and the Court being fully advised in the premises, and the Court having rendered its findings of facts and conclusions of law based thereon.

IT IS HEREBY ORDERED AND ADJUDGED that the Plaintiff, Robert E. Parker, Trustee of Olympia Construction Company, be, and hereby is, granted a Judgment against the Defendant, Mario Trucking Co., in the amount of Twenty-five Thousand and 00/100 Dollars ($25,000.00).

/s/ Harold H. Bobier
Judge in Bankruptcy

APPROVED:

CROSS, WROCK, MILLER & VIESON

By /s/ Andrew A. Paterson (P18690)
Attorneys for Trustee
4200 Penobscot Building
Detroit, Michigan 48226
965-8135

/s/ By ROBERT A. ROSENBERG
Attorney for Bankrupt
9817 East Grand River Avenue
Brighton, Michigan 48116
227-2020

APPROVED AS TO FORM ONLY:

D'AVANZO & DANKO

By /s/ STEPHEN G. DANKO (P12488)
Attorneys for Defendant
12154 Dix-Toledo Rd.
Southgate, Michigan 48195
282-1611

JUDGMENT ORDER

(United States District Court
Eastern District of Michigan Southern Division)

(Filed September 29, 1975)

In re: OLYMPIA CONSTRUCTION COMPANY, a Michigan corporation, Bankrupt: ROBERT E. PARKER, Trustee in Bankruptcy, Plaintiff, vs. PRICE BROTHERS COMPANY, a Michigan corporation, DARREL PRIESTLY, PRIESTLY CONTRACTING, INC., a Michigan corporation, Defendants. Bankruptcy No. 74-60440.

At a session of said Court held in the Federal Building, Flint, Genesee County, Michigan, on the 30th day of Sept., 1975.

PRESENT: HONORABLE HAROLD H. BOBIER,
Bankruptcy Judge.

This matter having come on to be heard and tried by the Court, and testimony having been taken, argument having been heard and the Court being fully advised in the premises, and the Court having rendered its findings of facts and conclusions of law based thereon,

IT IS HEREBY ORDERED AND ADJUDGED that the Plaintiff, Robert E. Parker, Trustee of Olympia Construction Company, be, and hereby is, granted a Judgment against Defendants Darrel Priestly and Priestly Contracting, Inc., jointly and severally, in the amount of Six Thousand Eight Hundred Eighty-three and 56/100 Dollars ($6,883.56).

IT IS FURTHER ORDERED AND ADJUDGED that the Plaintiff, Robert E. Parker, Trustee of Olympia Construction Company, be, and hereby is, granted a Judgment against Defendant Price Brothers Company in the amount of Six Thousand Eight Hundred Eighty-three and 56/100 Dollars ($6,883.56).

/s/ Harold H. Bobier
Bankruptcy Judge

Approved As To Form:

DAVID, HAYWARD, KINGSEPP & HERTLER

By: JON H. KINGSEPP (P15982)
Attorneys for Defendant
Price Brothers Company
622 Washington Square Plaza
Royal Oak, Michigan 48067
548-7007

JUDGMENT ORDER

(United States District Court
Eastern District of Michigan Southern Division)

(Filed September 10, 1975)

In re: OLYMPIA CONSTRUCTION COMPANY, a Michigan corporation, Bankrupt: ROBERT E. PARKER, Trustee in Bankruptcy, Plaintiff, vs. DOUG SCHROEDER, INC., a Michigan corporation, Defendant. Bankruptcy No. 74-60440.

At a session of said Court held in the Federal Building, Flint, Genesee County, Michigan, on the 31st day of July, 1975.

PRESENT: HONORABLE HAROLD H. BOBIER,
Bankruptcy Judge

This matter having come on to be heard and tried by the Court, and testimony having been taken, argument having been heard and the Court being fully advised in the premises, and the Court having rendered its findings of facts and conclusions of law based thereon.

IT IS HEREBY ORDERED AND ADJUDGED that the Plaintiff, Robert E. Parker, Trustee of Olympia Construction Company, be, and hereby is, granted a Judgment against the Defendant, Doug Schroeder, Inc., in the amount of Eight Thousand One Hundred Seventeen and 32/100 Dollars ($8,117.32).

/s/ Harold H. Bobier
Bankruptcy Judge

APPENDIX B

11 USC §104. Debts which have priority

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an

involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding, including expenses necessarily incurred by a debtor in possession, receiver, or trustee in preparing the schedule and statement required to be filed by section 638, 778, or 883 of this title, shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling, or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and

at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate herein as determined by the court; and (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision c of section 107 of this title: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

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11 USC § 110. Title to property

(a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trade-marks, and in applications therefor: *Provided*, That in case the trustee, within thirty days after appointment and qualification, does not notify the applicant for a patent, copyright, or trade-mark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted unless for cause shown by the trustee the court grants further time to the trustee for making such election; and such applicant may, in any event, at any time petition the court to be revested with such title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise

seized, impounded, or sequestered: *Provided*, That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process: *And provided further*, That when any bankrupt, who is a natural person, shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and (8) property held by an assignee for the benefit or creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this title, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

All property, wherever located, except insofar as it is property which is held to be exempt, which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or thei· appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.

All property, wherever located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy.

The title of the trustee shall not be affected by the prior possession of a receiver or other officer of any court.

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